EXPEDITORS INTERNATIONAL OF WASHINGTON INC
Form 8-K
March 22, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report: March 22, 2006

(Date of earliest event reported)

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.

(Exact name of registrant as specified in its charter)

Washington	**000-13468**	**91-1069248**

(State or other jurisdiction of incorporation or organization)	(Commission File No.)	(IRS Employer Identification Number)

1015 Third Avenue, 12th Floor, Seattle, Washington	**98104**
(Address of principal executive offices)	(Zip Code)

(206) 674-3400

(Registrant s telephone number, including area code)

N/A

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 7.01. Regulation FD Disclosure.

The following information is included in this document as a result of Expeditors policy regarding public disclosure of corporate information. Answers to additional inquiries, if any, that comply with this policy are scheduled to become available on or about March 24, 2006.

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS UNDER SECURITIES LITIGATION REFORM ACT OF 1995; CERTAIN CAUTIONARY STATEMENTS

Certain portions of this document including the answers to questions 1, 2, 4, 6, 8, 9, 10, 13, 15, 19 and 20, contain forward-looking statements which are based on certain assumptions and expectations of future events that are subject to risks and uncertainties. Actual future results and trends may differ materially from historical results or those projected in any forward-looking statements depending on a variety of factors including, but not limited to, changes in customer demand for Expeditors services caused by a general economic slow-down, inventory build-up, decreased consumer confidence, volatility in equity markets, energy prices, political changes, or the unpredictable acts of competitors.

RESPONSES TO SELECTED QUESTIONS REGARDING FOURTH QUARTER 2005 RESULTS

1. Could you please address the company s opportunity to pick up additional market share due to several large mergers in the international freight forwarding industry that could cause disruption at those entities?

We agree with your assertion that mergers can, and do, cause disruptions in the global logistics industry, but no matter what else we may say here we don t want to leave anybody with the impression that our growth strategy involves waiting for a feeding frenzy that is caused when established names bite the dust. We focus our efforts on attracting and retaining business, no matter what they may be doing to each other. That said, we would like to offer our view as to why mergers cause disruptions at the merging entities. We do this, confident that we are unlikely to change the urge to merge. After all, the fees earned from the endeavor are just too big to ignore.

As we have said many times, this is a service business. In the final analysis, we each are selling transportation wrapped in varying degrees and flavors of customer service. Customer service can only be delivered through individual execution with every shipment or customer contact. It is our view that these attempts at individual execution are wholly-dependent on the morale, the *espirit de corp* if you will, of the individuals employed at an organization. Inject a merger into this mix and you no doubt are adding a great deal of uncertainty and stress. This is not good for morale or execution. Even if you were able to eliminate the stress and uncertainty from the event, you are creating an environment where people who were competitors, perhaps vicious competitors as the competition is very keen in this business, are now thrust together and told to cooperate while the experts seek the promised merger synergies. That even the best merger possible generates opportunity for the uninvolved really goes without saying.

Customers also have reactions to merger activity. It is not uncommon for a shipper upon learning that their logistics company has been acquired, or is being acquired, by another logistics company, to hedge their bets by bringing in one new provider. They do this to ensure they have viable options should the merger begin to degrade service standards. As a result, freight which may have been locked up for years goes into play following a merger announcement. We try to be available for these potential customers.

All of the foregoing having been said, we can t quantify anything and we re not going to make predictions, nor are we going to telegraph potential customers where we think we might have opportunities. As always, we are looking forward to increasing our market share as mergers open up new opportunities that may have heretofore been unavailable to us.

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2. *Could you please comment on the demand/supply balance within the air cargo segment?*

As of mid-March 2006, not bad timing for the February 8-K, we don t see any real disconnect between supply and demand in the air cargo segment.

3. *Rent and occupancy costs declined sequentially during the fourth quarter of 2005 when compared with the third quarter. Yet, historically this expense has increased. Was there something one time in nature during the fourth quarter this past year that brought this expense line down? How should we look at this expense going forward?*

There were several things that affected rent expense during the fourth quarter of 2005. First, we moved from rented space to company-owned space in a couple of large markets, causing the rent expense to decline. Second, we also started to bill a customer for some rent on a pass-through basis that we had previously been billing as a bundled cost of a logistics offering.

4. *What are Expeditors expectations for stock option expense impact during 2006 and would you please discuss what you anticipate for the first quarter?*

This simple question, asked in many different ways, is part of the reason this Form 8-K was less than timely. In the name of full disclosure, the Form 8-K is also late because of the absurd time compression and additional effort that now goes into a year-end closing in the Sarbanes-Oxley era, but this has nothing to do with the answer to the question. As a complete aside, we take comfort in knowing that those who pushed hardest for option expensing (If it is not compensation, then what is it? went the cry) will likely get their own dose of sunshine next year with new compensation disclosures pending before the SEC.

Since 1996 under the old version of FAS 123, like all public companies, we have fully disclosed our stock option expense in our footnotes. We believe that we have also done a fair job of fully disclosing total compensation. We say this because we don t tend to burden our results with undisclosed perks and over the top business expenses . We doubt everyone can make the same claim. The future may well be full of additional interesting information, but the financial impact from option expensing has been fully disclosed. As you will shortly see, in terms of predicting future expense, the devil is in the details.

The following table shows what stock compensation expense has been for the years from 2000 through 2005 (in thousands):

		2000	2001	2002	2003	2004	2005
Net Income as reported	**$**	**83,035**	**97,243**	**112,529**	**121,952**	**156,126**	**218,634**
Net Income, including stock compensation expense	**$**	**73,090**	**82,934**	**93,656**	**98,400**	**128,992**	**187,138**
Diluted EPS as Reported	**$**	**0.76**	**0.89**	**1.03**	**1.12**	**1.41**	**1.96**
	$	**0.69**	**0.78**	**0.89**	**0.91**	**1.17**	**1.70**

Diluted EPS including Stock Compenstation Expense							
Stock compensation expense	**$**	**11,096**	**16,006**	**21,725**	**26,097**	**29,620**	**33,857**

As of mid-March 2006, we don t really know what our total stock option expense will be for 2006. What we do know is that we will likely issue 64,000 directors options at fair market value of our stock on the first trading day in June, 2006 (the grant date) and we will be asking for shareholder ratification of our 2006 Stock Option Plan which would authorize grants of an additional 1,500,000 shares at the grant date fair market value. This is in keeping with our new policy of putting an option request to a shareholder vote each year. Our 2006 Stock Option Plan requests the same number of shares as the shareholder-approved 2005 plan, and our ability to grant options is limited to the same number of shares per employee. Also, just like the 2005 plan, the options under this plan can be granted only through April 30th of the following year. At this point we also think it is fair to speculate that if the plan is approved, more than 95 percent of these options are likely to be granted as of the date of the annual meeting as this is consistent with prior practice. We also know that we already have $28,567,000 in amortization expense

for unvested stock options and employee stock purchase plan activity related to grants made in 2001 through 2005 pursuant to prior shareholder votes. That covers what we know.

What we don t know at this point is whether our shareholders will vote their approval of the 2006 Stock Option Plan and we certainly don t know what our stock price will be two and three months from now. Nor do we really have much more than a guess about the expected enrollment in the employee stock purchase plan for the plan year that will begin on August 1, 2006. Hence, we really cannot know the answer to your question. However, in keeping with the spirit of FAS 123R, we are not going to let uncertainty and imprecision stop us now as these are the very keystones of option expensing and as we all should know if option expensing is not now GAAP, than what is it?

While we know we already have $28,567,000 in 2006 option expense, just how presumptuous are you asking us to be in forecasting the 2006 expense? Are you asking that we predict a stock price as of May 3, 2006 and add 7/60 s of the expense (there are almost seven full months between this date and the end of 2006 for options that, if approved, will vest over sixty months which is another way of saying five years) for stock options to be granted to as yet unidentified key employees in individual amounts that have yet to be determined? We don t know.

We did take a look and discovered that we actually have a pretty good historical record as to what our option expense might be at least when the expense is expressed as a percentage of the fair market value of our stock on the day our grants have been made. If this were a television commercial, instead of an answer included in a very late Form 8-K, a smooth voice would be reminding us all that past performance is not a guarantee of future results , but nobody really listens do they? Valid or not as a predictor, we now present data going back to the turn of this century. For each grant, the fair value was determined using the Black-Scholes calculation as set forth in our footnote disclosure.

Grants	Market Values		Fair Values		%
03-May-00	$	18.95	$	10.78	56.9%
01-Jun-00	$	20.69	$	10.69	51.7%
29-Dec-00	$	26.85	$	15.27	56.9%
09-May-01	$	24.86	$	12.55	50.5%
01-Jun-01	$	31.93	$	16.12	50.5%
08-May-02	$	28.58	$	13.45	47.1%
08-May-02	$	34.30	$	11.94	34.8%
03-Jun-02	$	28.95	$	13.62	47.1%
28-Jun-02	$	33.16	$	15.61	47.1%
07-May-03	$	36.59	$	18.60	50.8%
02-Jun-03	$	34.88	$	19.77	56.7%
05-May-04	$	41.73	$	20.96	50.2%
01-Jun-04	$	46.88	$	26.89	57.4%
04-May-05	$	48.89	$	25.24	51.6%
01-Jun-05	$	51.53	$	28.36	55.0%
30-Jun-05	$	49.81	$	25.72	51.6%
30-Sep-05	$	56.78	$	29.32	51.6%
Average	$	36.20	$	18.52	51.2%

As you can see, on average, the Black-Scholes calculation (and we suppose we shouldn t forget Merton if for no other reason than it gives more respectability to any abbreviation BSM calculation sounds better than BS calculation , albeit they are one and the same) yields a fair value that is fairly close to approximately fifty percent of the quoted price of the underlying stock.

So, if you really want us to estimate a worst case 2006 expense, we will assume that all of the 1,500,000 shares will immediately be granted in May, although we think this is likely high by 50,000 or so shares and we have no idea if the shareholders will approve a new plan. We then expect to issue 64,000 shares to four outside board

members on June 1, 2006. Since we have no idea what the stock price will be as of early May and early June, we are going to use the closing value on Friday, March 17, 2006 and speculate that applying the BSM calculation might yield a price for employee stock options of $41.37 each without making any significant adjustment for anticipated turnover. The director s options, which have a higher historical BSM value to fair market value on grant date, we will speculate might be worth $43.95. At this point, the only thing we will say is that we know we are virtually certain that these numbers will turn out to be wrong. But on we go, oh how simple this all is as we make it up.

Multiplying the share grants by our fictional BSM values, we compute an unamortized stock compensation expense for the options not yet granted in 2006, ignoring the employee stock purchase plan, of about $64,859,000. As a point of reference, this number is about 11.7% of total 2005 cash compensation expense which we know for certain was $557,730,000.

Now, the expense from most of these options need to be amortized over the vesting period of three to five years. The exceptions are 1) the 64,000 director s options (approximately $2,813,000 in fair market value under the legion assumptions above), which will now cliff vest one year after grant and 2) the cost of the employee stock purchase plan for the 2006-07 plan year, which we have yet to value in this example. However, the expense from both of these plans will amortize ratably over a one-year period from the date of the respective grants.

Using straight line vesting for all of these as yet ungranted options under our director s plan and the as yet unapproved 2006 Stock Option Plan, we expect to add $9,397,000 to the $28,567,000 already scheduled to be amortized for a total of $37,964,000 ignoring, expense from the 2006/2007 portion of the employee stock purchase plan.

We must turn now to an examination of the estimated expense for shares under the employee stock purchase plan. Here again, we could launch into the beyond by seeking meaningless precision with respect to future events or we could use recent history to guide a wild guess. In preparation for this tough choice we wish to set out the following table which presents the footnote BSM expense for our employee stock purchase plan:

Fiscal Year	Expense Disclosure		Plan Year	Expense Disclosure	
2002	$	2,927,000	2002/2003	$	2,742,000
2003	$	3,073,000	2003/2004	$	3,536,000
2004					